



State of California
Employment Training Panel

Arnold Schwarzenegger, Governor

October 28, 2008

Rick de León
Distribution Center Manager
Walgreen Company
17500 Perris Blvd.
Moreno Valley, CA 92551

Dear Mr. de León:

Enclosed is our final audit report relative to the Employment Training Panel Agreement No. ET04-0585 for the period December 30, 2003 through December 29, 2005.

We did not receive a response to the draft audit report; therefore, our findings and recommendations remain unchanged.

Also enclosed is a demand letter for payment of costs disallowed in the audit report. Payment is due upon receipt of this letter. If you wish to appeal the audit findings, you must follow the procedure specified in Attachment A to the audit report.

We appreciate the courtesy and cooperation extended to our auditor during the audit. If you have any questions, please contact Charles Rufo, Audit Director, at (916) 327-5439.

Sincerely,

Original signed by:

Charles Rufo
Audit Director

Enclosures

cc: Mayra Terry, Human Resource Manager
Lethia Perry, Human Resource Generalis

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WALGREEN COMPANY

Agreement No. ET04-0585

Final Audit Report

For The Period

December 30, 2003 through December 29, 2005

Report Published October 28, 2008

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AUDITOR'S REPORT

Summary

We performed an audit of Walgreen Company's compliance with Agreement No. ET04-0585, for the period December 30, 2003 through December 29, 2005. Our audit pertained to training costs claimed by the Contractor under this Agreement. Our audit was performed during the period September 4, 2007 through September 7, 2007, except for Finding No. 3, for which our report is dated November 13, 2007.

The Employment Training Panel (ETP) reimbursed the Contractor a total of \$366,281.11. Our audit supported \$103,915.11 is allowable. The balance of \$262,366 is disallowed and must be returned to ETP. The disallowed costs resulted from 409 trainees who received ineligible training, 45 trainees who had insufficient training documentation, and 9 trainees who did not meet minimum wage requirements. We also noted an administrative finding for inaccurate reporting of trainee wage rates.

AUDITOR'S REPORT (continued)

Background

Founded in 1901, Walgreen Company (Walgreens) is a retail pharmacy chain with over 4,000 retail locations in 44 states and Puerto Rico. The company is headquartered in Illinois, but employs over 8,000 Californians. Its Moreno Valley distribution center began operation in May 2004 to distribute merchandise to retail stores located in Southern California, Arizona, Washington and Nevada.

Since the distribution center needed to be equipped with the newest technology in automated storage and retrieval systems, Walgreens proposed to train approximately 600 newly hired employees to operate state-of-the-art software-controlled technology to store and retrieve products for distribution to retail stores, as well as computer software-operated conveyor systems and automated guided vehicles needed for transportation of inventory pallets to the automated storage and retrieval systems and other drop off points. This training project therefore provided for training in Commercial Skills and Continuous Improvement.

This Agreement allowed Walgreens to receive a maximum reimbursement of \$1,000,428 for retraining 583 employees. During the Agreement term, the Contractor placed 468 trainees and was reimbursed \$366,281.11 by ETP.

Objectives, Scope, and Methodology

We performed our audit in accordance with *Government Auditing Standards*, promulgated by the United States General Accounting Office. We did not audit the financial statements of Walgreen Company. Our audit scope was limited to planning and performing audit procedures to obtain reasonable assurance that Walgreen Company complied with the terms of the Agreement and the applicable provisions of the California Unemployment Insurance Code.

Accordingly, we reviewed, tested, and analyzed the Contractor's documentation supporting training cost reimbursements. Our audit scope included, but was not limited to, conducting compliance tests to determine whether:

- Trainees were eligible to receive ETP training.
- Training documentation supports that trainees received the training hours reimbursed by ETP and met the minimum training hours identified in the Agreement.
- Trainees were employed continuously full-time for 90 consecutive days after completing training, and the 90-day retention period was completed within the Agreement term.

AUDITOR'S REPORT (continued)

- Trainees were employed in the occupation for which they were trained and earned the minimum wage required at the end of the 90-day retention period.
- The Contractor's cash receipts agree with ETP cash disbursement records.

As part of our audit, we reviewed and obtained an understanding of the Contractor's management controls as required by *Government Auditing Standards*. The purpose of our review was to determine the nature, timing, and extent of our audit tests of training costs claimed. Our review was limited to the Contractor's procedures for documenting training hours provided and ensuring compliance with all Agreement terms, because it would have been inefficient to evaluate the effectiveness of management controls as a whole.

Conclusion	As summarized in Schedule 1, the Summary of Audit Results, and discussed more fully in the Findings and Recommendations Section of our report, our audit supported \$103,915.11 of the \$366,281.11 paid to the Contractor under this Agreement is allowable. The balance of \$262,366 is disallowed and must be returned to ETP.
Views of Responsible Officials	<p>The audit findings were discussed with Mayra Terry, Human Resource Manager, and Lethia Perry, Human Resource Generalist, at an exit conference held on September 7, 2007. Subsequently, Ms. Terry and Ms. Perry were notified via e-mail on August 8 and 11, 2008, of the specific costs to be disallowed in the audit report. A draft audit report was issued to the Contractor on September 23, 2008. Following the issuance of this report, the Contractor had questions regarding Audit Finding No. 1 but no formal response to the draft audit report was received.</p> <p>The issuance of your final audit report has been delayed by the audit unit. Therefore, ETP waived the accrual of interest for the disallowed costs beginning November 13, 2007, through the issue date of this final audit report. The interest waiver (adjustment) was \$23,638.99, which was deducted from the total accrued interest.</p>
Audit Appeal Rights	If you wish to appeal the audit findings, it must be filed in writing with the Panel's Executive Director within 30 days of receipt of this audit report. The proper appeal procedure is specified in Title 22, California Code of Regulations, Section 4450 (attached).

AUDITOR'S REPORT (continued)

Records

Please note the ETP Agreement, Paragraph 5, requires you to assure ETP or its representative has the right, "...to examine, reproduce, monitor and audit accounting source payroll documents, and all other records, books, papers, documents or other evidence directly related to the performance of this Agreement by the Contractor... This right will terminate no sooner than four (4) years from the date of termination of the Agreement or three (3) years from the date of the last payment from ETP to the Contractor, or the date of resolution of appeals, audits, or litigation, whichever is later."

Charles Rufo
Audit Director

Fieldwork Completion Date: September 7, 2007, except for Finding No. 3, for which our report is dated November 13, 2007.

This report is a matter of public record and its distribution is not limited. The report is intended for use in conjunction with the administration of ETP Agreement No. ET04-0585 and should not be used for any other purpose.

SCHEDULE 1 – Summary of Audit Results

WALGREEN COMPANY

AGREEMENT NO. ET04-0585

FOR THE PERIOD

DECEMBER 30, 2003 THROUGH DECEMBER 29, 2005

	<u>Amount</u>	<u>Reference*</u>
Training Costs Paid By ETP	<u>\$ 366,281.11</u>	
Disallowed Costs:		
Ineligible Training Hours	224,130	Finding No. 1
Insufficient Training Hour Documentation	36,004	Finding No. 2
Minimum Wage Requirement Not Met	2,232	Finding No. 3
Inaccurate Reporting	<u>-</u>	Finding No. 4
Total Costs Disallowed	<u>\$ 262,366</u>	
Training Costs Allowed	<u><u>\$ 103,915.11</u></u>	

* See Findings and Recommendations Section.

FINDINGS AND RECOMMENDATIONS

FINDING NO. 1 – Ineligible Training Hours

Walgreen Company's (Walgreens) training documentation did not support the reported training hours nor did it meet the definition of classroom or laboratory training included in the Agreement. As a result, we disallowed training costs claimed for 409 trainees in the amount of \$224,130 for ineligible training hours reported by Walgreens.

The following criteria are applicable:

- Title 22 California Code of Regulations, Section 4400 (r) states "...the amount of ETP training cost reimbursement a contractor is entitled to [will be] based on the final billing per trainee. For payment to be earned, the trainee must complete the minimum number of training hours..." Exhibit A, page 6 of the Agreement required trainees to receive a minimum of 24 training hours.
- Title 22 California Code of Regulations, Section 4442(b) requires Contractor to maintain and make available records that clearly document all aspects of training. All classroom/laboratory training records must include hours of attendance and dates of training, be certified daily by the instructor during training, signed (or initialed) daily by the trainee, and signed by the trainer for each type of training.
- Exhibit A, Paragraph VI, D. 1. and 2., of the Agreement between ETP and Walgreens states "Classroom training is formal instruction provided to a group of individuals, in a classroom setting removed from the trainee's usual work environment, meeting regularly for training in a specific skill under the constant and direct guidance of a qualified trainer." Further, "Laboratory training is 'hands-on' instruction or skill acquisition conducted in a non-productive environment or simulated work setting under the direction of a laboratory trainer that may require the use of specialized equipment or facilities by the trainee. The trainer's time during laboratory training must be dedicated exclusively to the instruction of trainees."

Our initial audit sample included 55 (47 randomly selected and 8 judgmentally selected) of the 468 trainees placed in the Agreement. The Contractor provided the following training information: 1) original classroom training rosters; 2) "Team Member Orientation" training schedules; and 3) PowerPoint training presentation packets for "Week 1". Typically, trainees documented a total of 60.25 hours of training during a two-week Team Member Orientation (22.75 hours during Week 1 and 37.5 hours of training during Week 2). Actual Week 2 training varied by trainee from 29 to 37.5 hours.

FINDINGS AND RECOMMENDATIONS (continued)

Auditor's review of original training rosters found that each of the 55 trainees met ETP record keeping requirements during Week 1 ("Welcome to Walgreens", "Handbook Review", "Terminology", etc.). However, all trainer signatures were signed and dated to only validate Week 1 training. All Week 2 training rosters ("Equipment or Department training") were not certified by the instructor during training nor signed by the trainer for each training topic completed by a trainee. Thus, 45 of the 47 random trainees (96 percent error rate) had training hour deficiencies, along with the 8 judgmental trainees, due to invalid Week 2 training rosters. The amount disallowed for the initial audit sample was \$31,121 of \$42,163 reimbursed by ETP, as shown in the table below.

	Job No. 1
Trainees Placed	468
Random Statistically Selected Trainees [a]	47
Random Statistically Selected Trainees Disallowed [b]	45
Error Rate [b] ÷ [a]	96%
Non-Random Selected Trainees [c]	8
Non-Random Selected Trainees Disallowed [d]	8
Total Trainees Audited [a] + [c]	55
Total Audited Trainees Disallowed [b] + [d]	53
Total Costs Disallowed for Trainees Audited	\$31,121

Additionally, on September 9, 2007, ETP Auditor conducted on-site interviews regarding the training reported during Week 2 with Trainee Nos. 65, 312, and 372, who were employed as General Warehouse staff. Auditor was informed that during Week 2 of the reported training, trainees were performing the following tasks: 1) "cleaning DC [Distribution Center] preparing for product arrival in May"; 2) "wiping down racks, dusting racks, about it all day"; 3) "repacked damaged products to resend or donate [and] worked alone some of the time"; and 4) "mainly clean and put stickers on totes, cleaning every department pretty much." In some instances, trainees may have been supervised but generally trainees were

FINDINGS AND RECOMMENDATIONS (continued)

performing unsupervised routine job duties as part of their daily work assignments in their usual work environment.

Based on the inadequate and incomplete training documentation, trainee responses, and general description of Week 2 training, it was not conducted in a manner that was eligible for ETP funding. Without any trainer signatures documented during Week 2, ETP cannot determine who the primary trainer was or what constituted training costs during this training. Additionally, the training reported during Week 2 does not meet ETP's definition of classroom or laboratory training since it was not "conducted in a non-productive work environment or simulated work setting" nor was it "removed from the trainee's usual work environment." Also, at times, the trainee's were engaged in productive work.

In lieu of extrapolating a probable error rate based on the initial statistical sample audit results (96 percent error rate), ETP Auditor performed a review and analysis for each of the remaining 413 placed trainees to identify those trainees with training reported during Week 2. The expanded review determined that 356 of the 413 trainees (86 percent error rate) were found to have also reported material ineligible training hours during Week 2. The amount disallowed for the remaining 356 trainees was \$193,009. For audit materiality, all trainees who received at least 22.75 of the 24 required training hours had only a portion of their training costs disallowed. However, for all trainees whose training rosters supported less than 22.75 hours, the entire cost per trainee was disallowed. Please see Attachment 1, Finding No. 1, for a detailed break-out of ineligible and audited training hours by trainee.

Thus, training hours were disallowed for a total of 409 trainees (53 initial audit sample + 356 expanded audit sample) or 87 percent of trainees placed. The total costs disallowed were \$224,130 (\$31,121 + \$193,009).

Recommendation Walgreens must return \$224,130 to ETP. In the future, the Contractor should ensure that training records maintained comply with record keeping requirements in Title 22 CCR Section 4442. Also, training must meet the definition of classroom or laboratory training included the Agreement prior to claiming reimbursement from ETP.

FINDINGS AND RECOMMENDATIONS (continued)

FINDING NO. 2 – Walgreens training documentation was missing and/or did not
Insufficient support the total number of training hours reported for 45 Job No. 1
Training Hour trainees. As a result, we disallowed training costs claimed for these
Documentation trainees in the amount of \$36,004.

The following criteria are applicable:

Title 22 California Code of Regulations (CCR), Section 4442(b) requires Contractors to maintain and make available records that clearly document all aspects of training. Classroom/laboratory training records must include the training date(s) and hours attended, training type, and the trainer and trainee's signatures.

Paragraph 2 (b) of the Agreement states: "Each trainee should complete 100% of the required class/lab and videoconference training hours. Reimbursement for class/lab and videoconference training for trainees in job number 1 will be based on the total actual number of training hours..., up to the maximum specified in Chart 1, providing the minimum and no more than the maximum hours are met." Exhibit A, Chart 1, page 5 of 6, required that Job No. 1 trainees complete between 24 to 200 class/lab hours.

Paragraph 5 a.1. of the Agreement states in part that "Records must be retained within the control of the primary Contractor and be available for review at the Contractor's place of business within the State of California..."

Walgreens was unable to locate any training records for 20 trainees who had reported training in 2005 and 21 trainees who had reported training between July 5, 2004, and July 16, 2004. Please see Attachment B, Table of Disallowed Trainees, for trainees with specific comments.

Additionally, Trainee Nos. 435 and 439 did not appear on rosters reported during February 16-20, 2004 and July 5-16, 2004, respectively. Also, Trainee Nos. 435 and 439 each had 37.5 ineligible Week 2 training hours. Trainee Nos. 450 and 454 did not appear on rosters reported during February 23-27, 2004. Trainee No. 448's name was crossed-out on training rosters for 60.25 of the 62.25 hours reported.

Recommendation Walgreens must return \$36,004 to ETP. In the future, the Contractor should ensure that training records are retained for ETP's review and support the reported number of training hours as required by the Agreement prior to claiming reimbursement from ETP.

FINDINGS AND RECOMMENDATIONS (continued)

FINDING NO. 3 – Minimum Wage Requirement Not Met

Trainee employment information shows that nine trainees did not meet the minimum wage requirement specified in the Agreement. Since a portion of training costs were previously disallowed for 7 of the 9 trainees, this finding only disallowed the remainder. Trainee Nos. 233 and 448 were previously disallowed in Finding Nos. 1 and 2, respectively; thus no additional costs are incurred regarding these trainees. As a result, we disallowed \$2,232 in training costs.

Exhibit A, paragraph VI. A. of the Agreement between Walgreens and ETP states, “Each trainee must be employed full-time... for a period of at least ninety (90) consecutive days immediately following the completion of training... Wages at the end of the 90-day retention period shall be equal to or greater than the wages listed in [the Agreement].”

The Agreement required that Job No. 1 trainees earn a minimum wage rate of \$10.98 per hour following the post-training retention period. The Agreement allowed the Contractor to include the dollar value of employer-paid health benefits to meet minimum wage requirements.

The review of payroll records and health benefit documentation from Walgreens shows that nine trainees did not meet ETP minimum wage requirements. Payroll records show that each of the trainees had an hourly wage reported by Walgreens at \$11.00 per hour but they actually earned \$10.25 per hour. Review of health benefit documentation confirmed that each of the 9 trainees had not received health benefits. The table below shows the hourly wage rate reported by Walgreens, the required wage rate, and actual wage rate from payroll records:

Trainee No.	Job No.	Reported Wage Rate	Required Wage Rate	Total Actual Wage Rate
29	1	\$11.00	\$10.98	\$10.25
65	1	\$11.00	\$10.98	\$10.25
140	1	\$11.00	\$10.98	\$10.25
145	1	\$11.00	\$10.98	\$10.25
200	1	\$11.00	\$10.98	\$10.25
213	1	\$11.00	\$10.98	\$10.25
233	1	\$11.00	\$10.98	\$10.25
448	1	\$11.00	\$10.98	\$10.25
370	1	\$11.00	\$10.98	\$10.25

Recommendation Walgreens must return \$2,232 to ETP. In the future, the Contractor should ensure trainees meet the minimum wage rate requirements with (or without) employer-paid health benefit costs prior to claiming reimbursement from ETP.

FINDINGS AND RECOMMENDATIONS (continued)

FINDING NO. 4 – Trainee hourly wage rates reported by Walgreens on invoices submitted to ETP were inaccurate. As a result, the Contractor did not comply with the Agreement reporting requirements.

Inaccurate
Reporting

Paragraph 2(d) of the Agreement states, “Contractor shall submit invoices and necessary statistical data to ETP in form and manner prescribed by ETP”. Accurate, complete trainee wage rate information is required to verify compliance with Exhibit A, page 5, paragraph VII-A of the Agreement. This section states, “Each trainee must be employed full-time... for a period of at least ninety (90) consecutive days immediately following the completion of training... Wages at the end of the 90-day retention period shall be equal to or greater than the wages listed in [the Agreement].”

We documented actual trainee wage rates for 47 sample trainees. Actual wage rates were identified from payroll information provided by Walgreens. Trainee wage rates reported by Walgreens varied by 5 percent or more from actual wage rates for 22 out of 47 trainees (47 percent).

Recommendation In the future, Walgreens should ensure all trainee wage rates submitted to ETP are accurate and complete. Inaccurate or incomplete data may result in repayment of unearned funds, plus applicable interest to ETP.

ATTACHMENT A - Appeal Process

4450. Appeal Process.

- (a) An interested person may appeal any final adverse decision made on behalf of the Panel where said decision is communicated in writing. Appeals must be submitted in writing to the Executive Director at the Employment Training Panel in Sacramento.
- (b) There are two levels of appeal before the Panel. The first level must be exhausted before proceeding to the second.
 - (1) The first level of appeal is to the Executive Director, and must be submitted within 30 days of receipt of the final adverse decision. This appeal will not be accepted by the Executive Director unless it includes a statement setting forth the issues and facts in dispute. Any documents or other writings that support the appeal should be forwarded with this statement. The Executive Director will issue a written determination within 60 days of receiving said appeal.
 - (2) The second level of appeal is to the Panel, and must be submitted within 10 days of receipt of the Executive Director's determination. This appeal should include a statement setting forth the appellant's argument as to why that determination should be reversed by the Panel, and forwarding any supporting documents or other writings that were not provided at the first level of appeal to the Executive Director. If the Panel accepts the appeal and chooses to conduct a hearing, it may accept sworn witness testimony on the record.
 - (A) The Panel must take one of the following actions within 45 days of receipt of a second-level appeal:
 - (1) Refuse to hear the matter, giving the appellant written reasons for the denial; or
 - (2) Conduct a hearing on a regularly-scheduled meeting date; or
 - (3) Delegate the authority to conduct a hearing to a subcommittee of one or more Panel members, or to an Administrative Law Judge with the Office of Administrative Hearings.
 - (B) The Panel or its designee may take action to adopt any of the administrative adjudication provisions of the Administrative Procedures Act at Government Code Section 11370 *et seq.*, for the purpose of formulating and issuing its decision. Said action may take place at the hearing, or in preliminary proceedings.
 - (C) Upon completion of the hearing, the record will be closed and the Panel will issue a final ruling. The ruling may be based on a recommendation from the hearing designee. The ruling shall be issued in a writing served simultaneously on the appellant and ETP, within 60 days of the record closure.
- (c) The time limits specified above may be adjusted or extended by the Executive Director or the Panel Chairman for good cause, pertinent to the level of appeal.
- (d) Following receipt of the Panel's ruling, the appellant may petition for judicial review in Superior Court pursuant to Code of Civil Procedure Section 1094.5. This petition must be filed within 60 days from receipt of the Panel's ruling.

Authority: Section 10205(m), Unemployment Insurance Code; Section 11410.40, Government Code.

Reference: Sections 10205(k), 10207, Unemployment Insurance Code.

Effective: April 15, 1995

Amended: December 30, 2006